HOUSING MARKET OUTLOOK

Sherbrooke

Canada Mortgage and Housing Corporation

www.cmhc.ca

SPRING 2006

Signs of Changing Economic Conditions Appear

After registering seven years of growth, the labour pool remained practically unchanged in 2005 (-200 jobs) in the Sherbrooke census metropolitan area (CMA). In addition to this lack of new employment opportunities, there was a decrease in full-time positions (-1,500) in favour of part-time jobs (+1, 300). Furthermore, as an indication that potential workers are sensing a deterioration in market conditions, the rate of activity declined by close to one percentage point last year and reached 65 per cent.

Signs of increasing gloominess are also emerging from the consumer confidence index, which is generally on the decline. More particularly, fewer Quebec residents thought that it was a good time to make an outlay for a major item (home, car) in 2005 than the year before.

Over the forecast period, that is, 2006 and 2007, a few negative factors will affect the economic conditions prevailing in the area. The labour market will still not be able to bounce back, as net losses of 425 and

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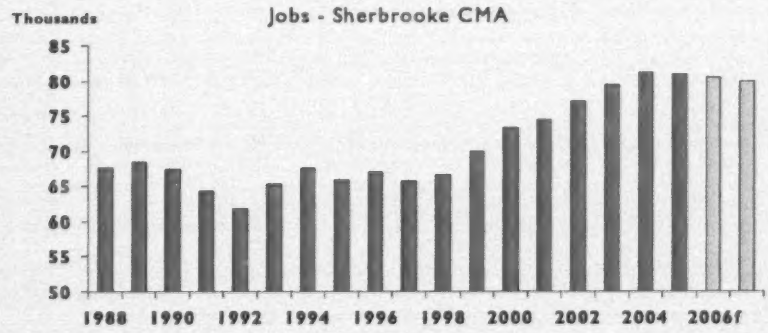
Labour Market Showing Signs of Slowing Down



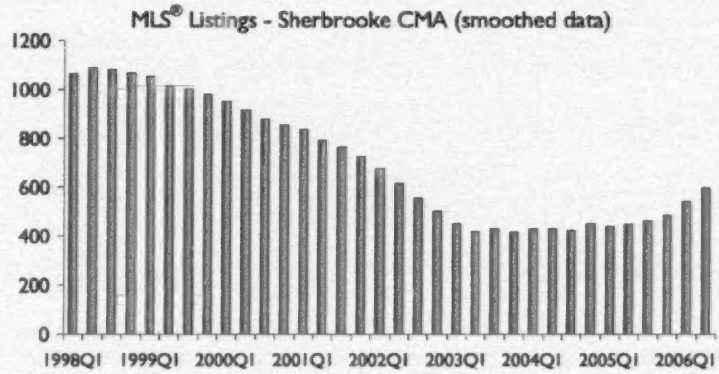
Source: CMHC f: forecasts

500 jobs will be registered in 2006 and 2007, respectively. The manufacturing sector will be hit once again. The strength of the Canadian dollar against the U.S. currency will not help the major exporting Estrie region. In addition, the quality of the jobs created will be lesser than that of the jobs lost, which has been the case for a few years already.

In 2006, the rising mortgage rates will be added to the lower confidence of households, which will make life more difficult for some. Short-term rates will increase the most. In fact, the average one-year mortgage rate will climb from 5.06 per cent in 2005 to 6.27 per cent in 2006. The average five-year rate, for its part, will rise from 5.99 per cent to 6.78 per cent over the same period. The impact will therefore be more marked for buyers who will be prepared to accept greater fluctuations in their mortgage payments and who will opt for a shorter term. During 2007, mortgage rates will rise by less than one quarter of a percentage point on average.

Despite the appearance of some negative areas, the fact remains that many people still have jobs in the Sherbrooke area and that interest rates remain historically low. Consequently, in 2006, apart from certain attenuating factors, the housing markets and related activities will maintain a large part of the momentum that has been characterizing them for the past few years. The adverse effects of the changing climate will start to be felt mainly in 2007.

Homes for Sale Rising Rapidly



Sources: CMHC and Chambre immobilière de l'Estrie (CIE)

Listings Rising More Rapidly

The number of existing homes for sale seems to want to increase rapidly and for good. While, in 2005, listings had risen little in relation to the year before (+35 units), since last October, real estate agents have put up a growing number of "For Sale" signs, such that, at the beginning of April, there were 716 listings in the Sherbrooke area, compared to 495 one year earlier. The last time a similar level of listings was observed dates back to 2001, that is, just before the start of the real estate boom.

The growing choice available to home buyers, combined with still favourable economic and financial conditions, will put upward pressure on sales for one last year in 2006, as transactions should reach 1,380 units this year. However, certain factors are indicating that the resale market is moving closer to a turning point. First of all, the increase in prices has started to slow down (13.3 per cent in the first quarter of 2005, compared to 9.3 per cent in the first quarter of this year). Also, the seller-to-buyer ratio is slowly easing. Not taking into account the rapid fluctuations[1], the ratio went from 4.5 to 1 to 5 to 1 between the last quarter of 2005 and the first quarter of 2006. In 2007, the gloomier economic climate in the area will combine with the declining affordability of existing homes and cause the resale market to lose some of its momentum. Sales will then fall to 1,230 units (-11 per cent).

Growth in Existing Home Prices Bound to Slow

Over the coming months, we should see the growth in home prices continue to slow down and market conditions ease rather rapidly. This situation will result from the steady rise in the supply of homes for sale and a somewhat weaker demand. At the beginning of April, 200 more homes than at the same last year were on the market, for an increase of 44 per cent in the supply.

Existing Home Prices to Climb More Slowly

Average MLS® Price – Sherbrooke CMA

2001	$94,300	3%
2002	$106,800	13%
2003	$117,000	10%
2004	$134,000	14%
2005	$150,800	13%
2006f	$161,400	7%
2007f	$167,900	4%

Sources: CMHC and Chambre immobilière de l'Estrie (CIE) f: forecasts

In 2006, the average price of Service inter-agences / Multiple Listing Service (S.I.A. / MLS)® transactions will attain $161,400. This will be the first time in four years that the increase will be less than 10 per cent. If the area was able to support such considerable hikes for so many years without excluding a large number of potential buyers, it was because mortgage rates remained low, salaries increased and property prices were very affordable before the real estate boom. In 2001, the average value of transactions was $94,300, and 58 per cent of sales involved properties priced at under $90,000.

During the current year, the resale market will move away from overheated conditions and become a seller's market. In 2007, this position will be consolidated, and the increase in prices will be limited to 4 per cent, which will bring the average price to $167,900. The market will have to become balanced again before the growth in prices can move closer to inflation (±2 per cent).

Housing Starts to Show Ups and Downs

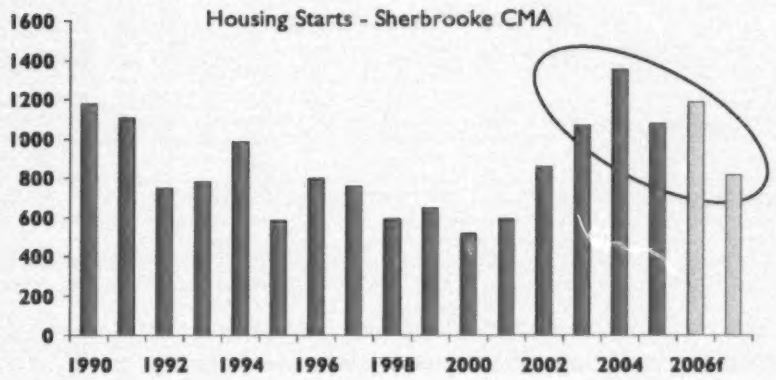
Given the aging of the population, real estate developers and major portfolio managers in Canada know that demand for retirement housing will remain steady. As well, they are aware that the current supply is short in several areas, including Sherbrooke. This new reality appears so promising that they are not hesitating to move out of the large centres to invest in the regions. As a result, construction will get under way on a 279-unit retirement home in 2006, which will cause the starts volume in Sherbrooke to go up and down over the period from 2005 to 2007. Had it not been for this new job site, starts would have fallen throughout this interval.

Driven by this major project, the production of rental apartments will jump up this year (550 units, compared to 345 last year). In 2005, rental housing construction had declined, in order to better match demand in the mid- and upper-range categories, the only types of housing that can be produced, given the high construction costs.

As for the construction of freehold homes, mainly single-family houses, 2006 will mark the beginning of the contraction phase. With more and more existing properties for sale, people will not have to turn to the new home market as much to become homeowners or meet their housing needs. In addition, the employment outlook is deteriorating, which is undermining consumer confidence. Finally, the difference between new and existing home prices has been steadily rising and now exceeds $25,000. The slowdown will take place progressively, as home starts will fall by 10 per cent this year and then by 29 per cent in 2007. In all, 600 freehold houses will get under way in 2006, compared to 663 last year. With 425 units expected for 2007, starts will return to their average level for the last 30 years.

The average price of new single-detached houses reached $177,110 in 2005. This average price will register robust growth again this year (+7 per cent) and attain $189,500 in 2006. The presence on the market of many baby boomers, who still have the upper hand on the labour market in the area, is not unrelated to this significant increase. Escalating construction costs, in an industry where demand remains high and succession is scarce, also justify part of this gain. In 2007, the growth in prices should be limited to 3 per cent, on account of the weaker demand and also because of a change in the demand mix. During periods

Housing Starts Show Ups and Downs



Source: CMHC f: forecasts

when demand declines considerably, developers start offering a wider range of products, which grows mainly through the addition of less expensive models.

Market Zones at a Glance

The start of construction on the major new retirement home, along with expansion projects under way in two existing residences, will give back to the North district (former city of Sherbrooke) the title of top provider of private retirement housing. Given the large quantity of housing units for pre-retirees and condominiums situated there, this market zone consolidated its vocation as the place of choice for Sherbrooke's aging population.

The East district (former city of Sherbrooke) will be the site of some major investments over the coming years. In fact, the expansion of the Hôtel-Dieu Hospital will change the life of this neighbourhood for three years. The construction of an indoor soccer centre will add to the already significant offer of sports services in this sector. The zone situated near the King Bridge will be revitalized by the Municipal Housing Bureau, which will move its offices there and add some affordable housing in the area. Lastly, a new supermarket will be developed there. All these investments will not lead to the production of a significant number of housing units in the short term, but they will contribute to increasing the supply of services and the economic vitality of this mostly working-class sector. Over the longer term, the impact on the demand for new housing can only be positive for this sector and the Fleurimont zone.

Vacancy Rate to Keep Rising Slowly

Once again, over the forecast period, immigration will be the driving force behind the new demand for rental housing, even if international migration is bound to decrease slightly. In general, Sherbrooke receives 1,000 people from abroad, not 1,400 as was the case in 2003-2004. Apart from this factor that stimulates demand, the determining variables on the rental housing market will all evolve in such a way as to put upward pressure on the vacancy rate over the next two years. The supply of new units will remain high in 2006 and increase in 2007 thanks, in part, to the arrival on the market of the new 279-unit retirement home. As well, this substantial increase in supply will come at a time when demand for rental housing will be declining on account of a less favourable labour market and a continued strong homeownership trend in 2006. These factors will ease the upward pressure on demand resulting from the increase in immigration. The vacancy rate will therefore rise gradually, from 1.2 per cent in 2005 to 1.6 per cent in 2006 and then to 2.0 per cent the following year.

In a tight market, it is natural to see a rapid increase in rents. Last year, however, the rise in the average rent for two-bedroom units[2] was limited to 2 per cent, while inflation reached 2.25 per cent. Over the forecast horizon, the rent increases will also be in line with inflation (± 2 per cent).

[1] Smoothed data is then used.

[2] Two-bedroom units are often used to give and idea of the general trend on the market. Since the housing stock comprises many units of this type, the increase in posted rental rates is less biased by the arrival of new units, which are often very expensive in comparison with existing apartments.

FORECAST SUMMARY

Sherbrooke Census Metropolitan Area

Spring-Summer 2006

	2005	2006f	% Chg.	2007f	% Chg.
RESALE MARKET					
MLS® sales	1,287	1,380	7%	1,230	-11%
Average MLS® price ($)	150,800	161,400	7%	167,900	4%
NEW HOME MARKET					
Housing starts					
Total	1,076	1,190	11%	815	-32%
Freehold	663	600	-10%	425	-29%
Rental	345	550	59%	350	-36%
Condominium	68	40	-41%	40	stable
Average price ($)					
Single-detached houses	177,110	189,500	7%	195,185	3%
RENTAL MARKET					
Vacancy rate (October) (%)	1.2	1.6	n/a	1.9	n/a
Rent (2-bedroom) ($)	505	515	2%	528	3%
ECONOMIC OVERVIEW					
Mortgage rate - 3-year (%)	5.6	6.4	n/a	6.6	n/a
Mortgage rate - 5-year (%)	6.0	6.8	n/a	6.9	n/a
Employment level	80,925	80,500	-1%	80,000	-1%
Employment growth (number)	-200	-425	n/a	-500	n/a

f: CMHC forecasts

Sources: CMHC and Statistics Canada

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